2002-1 §4041
§4042
§4047
§4261
26 C.F.R. §1.412(c)(1)-3

[PBGC Letterhead]

MEMORANDUM

December 10, 2002

TO: Steven A. Kandarian
Executive Director

FROM: James J. Keightley / s /
General Counsel

SUBJECT: Legal authority for PBGC to terminate a pension plan, then immediately restore it, in order to provide more lenient funding requirements

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You have asked us to analyze whether PBGC has legal authority to terminate and then restore a pension plan in order to implement more lenient funding requirements for the plan sponsor (assuming there are defensible grounds for termination in the first instance). In our view, PBGC has no legal authority to take such an unprecedented course of action.

Discussion

Section 4047 of ERISA is the basis for PBGC's authority to restore a terminated pension plan. It has two sentences. The first addresses a situation where a plan "is to be terminated" or "is in the process of being terminated." In such a case, PBGC is authorized to "cease" termination activities and restore the plan to its prior status if PBGC determines that the plan should not be terminated "as a result of such circumstances as [PBGC] determines to be relevant." This sentence has no application to a plan as to which no termination activity is occurring; there is nothing to "cease." Even if it could somehow apply, such a "cessation" of termination activities would not help a plan sponsor seeking funding relief because the special funding rules for restored plans, discussed below, do not apply in such a case. *See* 26 C.F.R. § 1.412(c)(1)-3(a)(1) (the restoration funding method applies "in the case of certain plans that *are or have been terminated* and are later restored" by PBGC) (emphasis added).

The second sentence of section 4047 addresses the situation where a plan "has been terminated" under section 4041 or 4042 of ERISA. It empowers PBGC "in any such case in which [PBGC] determines such action to be appropriate and consistent with its duties under [Title IV], to take such action as may be necessary to restore the plan to its pre-termination status." As an initial matter, it seems clear that Congress envisioned that PBGC would exercise this authority, as it did in the LTV case, only *after* a pension plan has already terminated and PBGC decides, for some reason, that the termination should be undone.[1] Thus, it seems doubtful that this provision grants PBGC authority to determine, while a plan is still ongoing, that the plan should be terminated and in the next instant restored.

Even if this obstacle could be overcome, we think that PBGC's restoration authority, as broad as it is, is not broad enough to justify restoration solely for the purpose of giving an

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[1] The legislative history of section 4047 confirms this understanding. The 1974 Conference Report noted that this provision would allow PBGC to abandon termination proceedings "if the employer and plan enjoyed a favorable reversal of business trends, or if some other factor made termination no longer advisable." H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. 378, *reprinted in* 1974 U.S. Code Cong. & Admin. News 5038, 5157-58. This language clearly anticipates some change, occurring during termination proceedings or after termination, that would make termination "no longer" advisable. That concept is inconsistent with a "pre-packaged" termination-restoration.

employer a liberalized funding schedule. While section 4047 broadly authorizes restoration of a terminated plan whenever PBGC determines that restoration is "appropriate and consistent" with its Title IV duties, we do not believe it would be appropriate and consistent with PBGC's duties to use restoration in this manner.[2] It is Congress, and to a limited extent the IRS, that determine the minimum funding rules, not PBGC. Those statutory rules, which Congress has progressively tightened over the years, determine the length of time over which an employer must fund its pension liabilities. Moreover, the funding rules authorize the IRS, under specified circumstances of business hardship, to grant an employer a waiver of the funding requirements for the year in question. A termination-restoration transaction would run counter to that entire structure and would arrogate to PBGC the authority to determine minimum funding requirements.

The provisions governing the funding of restored plans were implemented in order to address the unique problems that arise when a plan is restored, not to authorize PBGC to grant funding relief. When a pension plan is restored, its funding requirements are established under companion regulations that PBGC and the IRS adopted in 1990 in connection with the LTV restoration. In its regulation, the IRS used its authority to "adapt the standards of section 412 to the extent necessary to provide rules for a special group of plans," and authorized PBGC to establish the funding schedule for restored pension plans, subject to important restrictions. 55 Fed. Reg. 42,705 (Oct. 23, 1990). This regulation (codified at 26 C.F.R. § 1.412(c)(1)-3) creates

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[2] PBGC formed an interdepartmental group in 1991 to analyze what grounds might justify restoration. Although no definitive list was ever finalized, the group generally agreed that the following grounds were among those that could warrant restoration: abuse of the insurance program, factual mistake, analytical mistake, changed financial circumstances, and changes in other circumstances such that the factors that led to termination no longer exist. Memorandum from David Lindeman to Diane Burkley et al. (June 10, 1991).

a "restoration method" that adapts the plan's underlying funding method to the "special circumstances that exist when a plan is restored." 55 Fed. Reg. 42,706.[3] The regulation creates a special "initial restoration amortization base," which consists of the unfunded liabilities of the plan as of its restoration, and provides that this base must be amortized pursuant to a "restoration payment schedule order," or "RPSO," issued by PBGC (PBGC's regulation is codified at 29 C.F.R. pt. 4047).

In authorizing PBGC to establish the funding schedule for restored plans, the IRS stressed the importance Congress placed on the tightened contribution requirements implemented in 1974 and 1987, and emphasized that the funding requirements of section 412 were not to be circumvented through issuance of a RPSO:

> It is also appropriate and essential to the effective administration of section 412 that the Secretary prescribe certain limits with respect to the restoration funding schedule in order to ensure that the schedule is consistent with and in furtherance of the congressional purposes underlying section 412.

55 Fed. Reg. 42,706-07. A variety of restrictions in the regulation serve to further this goal.[4]

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[3] Restoration creates unique problems with respect to plan funding. The plan's funding standard account is closed out at the time of termination, and must be reestablished at restoration. 55 Fed. Reg. 42,704. A plan ordinarily is underfunded upon termination, and the sponsor makes no contributions during the time it is terminated, resulting in even greater underfunding. As the IRS noted, "[t]his underfunding will be significantly increased if the plan has been administered as a terminated plan for an extended period of time." 55 Fed. Reg. 42,705.

[4] The initial restoration amortization base must be fully amortized over not more than 30 years. § 1.412(c)(1)-3(c)(2). PBGC may grant a deferral of an annual payment only if it determines that deferral is in the best interests of the participants and the insurance program, and that the plan sponsor and its controlled group members are unable to make the scheduled payments without experiencing temporary substantial business hardship. § 1.412(c)(1)-3(c)(4). PBGC may grant no more than five deferrals during the RPSO period, and may grant no more than three of these deferrals during the first ten years. Id. No deferral may extend the overall restoration payment period beyond 30 years. Any other PBGC modification of the RPSO must comply with the requirements of the regulation, including the minimum payment requirements

Nor is there anything in section 4047 (or elsewhere in ERISA or the Code) that authorizes PBGC to provide financial assistance to ongoing single-employer plans or to assist plans in avoiding the normal funding waiver application process. Indeed, although Congress explicitly amended ERISA to provide for financial assistance to multiemployer plans in 1980 (ERISA § 4261, 29 U.S.C. § 1431), it never authorized such assistance to single-employer plans.

In its 28 years of existence, PBGC has exercised its section 4047 restoration authority only once. In the LTV case, PBGC ordered restoration of three plans that had terminated nine months earlier after LTV created new "follow-on" pension plans that made up for the benefits not guaranteed by PBGC. This follow-on scheme, if not challenged, would have resulted in PBGC's effectively subsidizing an ongoing employer's pension program. Faced with this serious abuse of the pension insurance program, PBGC took the unprecedented step of restoring the previously terminated plans to LTV under section 4047. Three years of litigation ensued, with PBGC's restoration decision finally vindicated in the U.S. Supreme Court, followed by another three years of negotiations. The funding schedules that PBGC ultimately provided LTV took account of that extraordinary chain of events. In no way was the LTV restoration part of some termination-restoration package contrived to give LTV a break on its minimum funding obligations.

In sum, while PBGC has broad discretion to determine whether restoring a plan would

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and the 30-year restriction. § 1.412(c)(1)-3(c)(3). And PBGC must conduct a funding review of the plan at least annually, and PBGC's Executive Director must certify to the Board of Directors and to the IRS that it is in the best interest of the plan's participants and beneficiaries and the insurance program that the restored plan not be reterminated. § 1.412(c)(1)-3(i).

be appropriate and consistent with its duties under Title IV of ERISA, we believe that a purposeful effort to achieve an objective not permitted by the agency's governing statute – granting funding relief – would be overturned as exceeding our statutory authority. Indeed, PBGC's internal deliberations about what grounds might justify restoration produced strong concerns that the agency "could be criticized for using termination followed by a restoration with a RPSO as a way to dilute the minimum funding standards or to avoid the waiver process." Memorandum from David Lindeman to Diane Burkley et al. (June 10, 1991) at 7. Although there may be situations in which PBGC "could defensibly take into account the availability of a RPSO in deciding whether to restore," restoration "simply to permit a sponsor to evade the normal funding rules" would be indefensible. Id.[5]

[5] The former General Counsel reiterated this concern, stating: "[PBGC]'s actions would be governed by an arbitrary and capricious/abuse of discretion standard, and we could easily run afoul of those standards if it were shown that we terminated (and restored) simply to allow the sponsor a way to evade the normal minimum funding rules."